THE NATIONAL CITY BANK OF NEW YORK

1932

Economic Conditions
Governmental Finance
United States Securities

New York, June, 1932

The Financial Situation

THE program of the Federal Reserve Banks of buying large amounts of Government securities in the open market for the purpose of adding to the supply of loanable funds and checking the deflation of credit has been carried forward with vigor during the past month. Between April 13, when the program of accelerated buying was first announced, and the date of the latest bank statement (May 18), the Federal Reserve Banks purchased $480,000,000 of "Governments," bringing the total of these holdings to $1,466,000,000, the highest on record. Never before have open market operations on anything like so large a scale been attempted by a central bank. The action of the Federal Reserve authorities, therefore, marks a bold experiment in central banking practice, and one which, if successful, will contribute most importantly towards business recovery by freeing business from the weight of an over-reaching and destructive deflation.

In view of the magnitude of these operations it is perhaps inevitable that they should be labelled inflationary by many people in this country as well as abroad. It is apparent, however, that there is a good deal of misunderstanding of what has been taking place in our money market. As a matter of fact, action by the central bank to relieve the pressure of credit deflation had become imperative.

The Period Before the Credit Crisis

Until the middle of 1931 there could be no complaint as to the adequacy of the volume of bank credit available for business. In July 1931 the volume of member bank balances at the Reserve banks, constituting the basis of bank advances to customers, averaged $2,422,000,000, or somewhat higher than in September 1929 just before the first stock market break. Taking the banking system as a whole, its lending power was unimpaired, and declines in business volume and prices obviously could not be attributed to monetary pressure.

With the volume of bank reserves maintained at a fairly constant level, there was naturally a similar stability in the volume of bank credit outstanding to the public, although a considerable change took place in the form in which this credit was kept in circulation, loans being reduced and investments increased. The following table comparing the changes in bank loans and investments and deposits between September 1929 and July 1931 indicates very clearly the absence of any monetary pressure as an aggravating factor of the depression up to that time:

Weekly Reporting Member Banks
(In millions of dollars)

	Sept. 4, 1929	July 1, 1931	Change
Loans on Securities	$ 7,632	$ 6,746	— 886
Loans, All Other	9,518	7,945	—1,573
Investments	5,440	7,795	+2,355
Total Loans & Investments	22,590	22,486	— 104
Deposits	20,003	21,169	+1,166

Effects of Currency Hoarding and Gold Exports

Beginning after the middle of 1931, however, the situation changed. A new set of factors was introduced into the monetary sphere which radically altered the relationship between banks and business. The gradual increase in the number of bank failures, resulting from falling prices and difficulties in liquidating slow assets, caused a growing public uneasiness regarding the banks which manifested itself in withdrawals of currency for hoarding. The banks, in order to obtain currency to supply depositors' demands, were obliged to draw down their balances at the Reserve banks. Since these balances constituted the basis for outstanding credit their reduction involved a forced contraction of credit which had disastrous effects upon industry and trade. With cash reserves undergoing a steady shrinkage, the banking system had no choice but to contract loans and sell securities in order to keep its liabilities within the proportion to reserves specified by law. Thus, the decline of bank loans no longer reflected the normal processes of commercial liquidation, but became a driving force for continuous contraction. It had the effect, not of mending, but of aggravating the usual difficulties of the depression.

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Moreover, by September 1931 a new drain upon bank reserves had begun from another quarter. The departure of Great Britain from a gold basis led to heavy foreign withdrawals of short term balances from this country, further reducing member bank reserves and necessitating additional contraction of credit. Between an increase of $782,000,000 in currency in circulation between the end of June and February, and a decrease of $602,000,000 in gold holdings due to exports and earmarkings during the same period, the combined loss to member bank reserves amounted to $1,384,000,000.

Limitations on the Expansion of Federal Reserve Credit

It is true that the Reserve banks had huge excess reserves, and that a large part of the above loss to the money market was offset by an expansion of Federal Reserve credit which put funds at the disposal of member banks with which to make good the decrease in their reserve balances occasioned by currency withdrawals and gold exports. Between June 24 and February 24 the amount of Federal Reserve credit was increased by $774,000,000. Had it not been for this help by the Reserve banks the effect of the impact of gold and currency losses on the credit structure would have been far more serious than it was. Unfortunately, however, the amount of credit put out by the Reserve banks was not sufficient to fully offset the losses of reserve sustained on other accounts. This was due principally to two causes.

In the first place, at the time of these losses the Reserve banks did not have the power since conferred upon them by the Glass- Steagall Bill to use Government securities bought in the open market as collateral for Federal Reserve note issues. Hence their power to put credit into the market by adding to the Government security portfolio was limited.

In the second place, member banks are always reluctant to increase their indebtedness at the Reserve banks and do so only under increasing pressure. While in this instance they did borrow on a very large scale to make good the losses in their reserve balances, their rediscounts with the Federal rising from $198,000,000 at the end of June to somewhat under $850,000,000 in February, they effected at the same time what reductions they could in their outstanding credits.

As a result, the burden of supplying gold and currency was borne partly by the Reserve banks, and partly by commercial and other users of credit.

The Shrinkage in Bank Reserves and Deposits

The following table shows the course of member bank reserves by months and indicates the effect of these declines on the deposits of the banks involved.

Weekly Reporting Member Banks
(In millions of dollars)

End of Month	Member Bank Reserve Balance	Member Bank Deposits
June, 1931	$1,808	$21,169
July "	1,844	20,807
August "	1,787	20,254
Sept. "	1,816	20,378
Oct. "	1,714	18,968
Nov. "	1,608	18,488
Dec. "	1,833	18,115
Jan., 1932	1,482	17,462
Feb. "	1,416	16,981
Decrease, June-Feb.	392	4,188

It is a familiar fact that under the mechanism of our banking system member bank reserves are permitted to form the basis of a volume of deposits many times as great as the reserves themselves. At the end of June, last year, the ratio of reserves to deposits for all reporting member banks was about as 1 to 12. In other words, for every shrinkage of a dollar in reserves there would inevitably take place a contraction of $12 in deposits. The effect of this multiple contraction of credit in enormously magnifying the scale of deflation is illustrated vividly in the table, which shows that a loss of $392,000,000 in bank reserves over the eight months was accompanied by a reduction of $4,188,000,000 in deposits. In this tremendous shrinkage of bank credit alone there is enough to explain the indescribable confusion existing everywhere in industry and the misfortunes inflicted upon millions of people.

For a good many bankers living far from the centers immediately affected by gold exports and in communities not affected by currency hoarding the foregoing explanation of the decline in deposits may appear somewhat theoretical and hardly applicable to the situation locally. Nevertheless, the influence of these movements may easily become a factor in every local situation. Just as any important addition to the country's banking reserves at any given center, whether due to gold imports at New York or other causes, tends to spread its influence in expanding credit all over the country, in the same manner any large subtractions from reserves at any given point tend to make their influence felt in contracting credit in all sections. For example, the calling of a loan by a bank in New York to make an outpayment of gold may involve payment by the borrower by check on a bank half way across the continent, thus diminishing the latter's deposits. Still more important, a reduction in reserves, leading to a contraction of credit on a large scale, depresses commodity prices, forces suspension of industrial activity and throws people out of work so that they are forced to live on their savings.

Thus, in countless ways the effects of deflation, regardless of the place of origin, are carried to the remotest villages of the country.

The Situation in February 1932

Such was the burden of deflation against which business was being forced to contend in February of this year when the Reserve banks, their open market powers broadened by the Glass-Steagall Bill, began to put credit into the market through the purchase of Government issues.

Nor was the pressure of this deflation over in February. It is true that, thanks to the activities of the Reconstruction Finance Corporation, the number of bank failures was being sharply cut down, so that currency hoarding was no longer increasing and some money was beginning to come back to the banks. Moreover the panic abroad over the American dollar had subsided and gold was no longer going abroad in large volume. Thus, for the moment at least, the strain upon member bank reserves from these major sources was no longer increasing appreciably.

Nevertheless, the forces of deflation were by no means spent. In February, the volume of member bank indebtedness to the Reserve banks still stood between $800,000,000 and $850,000,000, a legacy from the period of outflowing gold and currency hoarding. So long as this indebtedness remained so large there was certain to be pressure for deflation, for every bank so indebted would struggle to get in cash until it could clear itself of its obligations. And all this meant continuous calling of loans and liquidation of securities. Had there been any marked return flow of currency or a turn of the tide of gold to this country, a reduction of rediscounts to more normal levels around $300,000,000 to $400,000,000 would have been easy, since every dollar of gold or currency deposited by a borrowing bank at the Reserve bank would have served to cancel a dollar of indebtedness. But to effect such a reduction through contraction of deposit credits would, at the ratio of contraction indicated in the preceding table, have involved a further reduction of approximately $4,800,000,000 in deposits. It is doubtful if even the most hard-boiled deflationist would advocate so drastic a course. The extent of additional devastation which would be wrought by any such prolongation of the deflation can only be imagined.

It will be clear, then, that the objectives of Federal Reserve policy have been, first, to assist in the liquidation of member bank indebtedness, thus eliminating this indebtedness as an influence for further deflation, and, second, to create a definite surplus of funds in the market with a view to easing credit and encouraging a more liberal lending policy on the part of member banks.

The means by which the Reserve banks have set about making their policies effective is the purchase of Government securities in the open market. It is of interest to see to what extent the objectives of Federal Reserve policy have been attained.

The Reduction of Member Bank Indebtedness

In the following table we show the weekly changes in Reserve bank credit by principal items since February 24 when the buying of Government securities was commenced.

Federal Reserve Bank Credit Outstanding
(In millions of dollars)

1932	Bills Discounted	Bills Bought	U. S. Gov. Securities	Total Reserve Bank Credit
Feb. 24	$835	$133	$741	$1,734
Mar. 2	828	116	760	1,729
" 9	748	138	785	1,698
" 16	661	106	842	1,634
" 23	666	82	835	1,597
" 30	633	66	872	1,587
Apr. 6	635	58	835	1,599
" 13	629	52	985	1,686
" 20	565	49	1,078	1,700
" 27	532	46	1,191	1,785
May 4	506	45	1,287	1,859
" 11	471	43	1,385	1,919
" 18	465	41	1,466	1,988

It will be seen that the purchases of Governments were at first carried on gradually until the week of April 13 when the rate of acquisition was stepped up to around $100,000,000 for several weeks. Total purchases for the entire period to May 18 amounted to $725,000,000.

What happened to the funds thus disbursed into the market?

Approximately $92,000,000 went into a reduction in the acceptance portfolio which decreased from $133,000,000 on February 24 to $41,000,000 on May 18. Over and above this amount, $370,000,000 went to bring about the desired reduction in rediscounts, the volume of which fell from $835,000,000 on February 24 to $465,000,000 on May 18, or by nearly one-half. While further reduction in rediscounts would doubtless be desirable under present conditions, the total now shown is no longer a serious burden upon the banking system. Thus within the space of three months the Reserve banks have practically achieved their first objective.

Considering that practically none of this indebtedness had been in the cities of New York and Chicago where most of the buying of Governments had to take place, and that funds therefore had to find their way out through the country in a more or less indirect manner, the promptness with which the effects of the Federal Reserve activities were manifested in the different Federal Reserve districts has been gratifying.

Rebuilding Member Bank Reserve Balances

With the marked reduction in rediscounts and the steady increase in the number of banks clear of the Federal Reserve indebtedness, the continued purchase of securities by the Reserve banks has had the effect of building up surplus reserves of member banks, which is the second objective of the Federal Reserve policy.

As will be seen from the table on changes in the different classifications of Reserve bank credit, the first few weeks of Government security buying resulted in no enlargement of Reserve bank credit outstanding, since funds put into the market through security purchases were more than offset by the reduction in rediscounts and in the acceptance portfolio. After March 30, however, there was a change in the trend, and continued purchases of Governments were accompanied by a rise of $401,000,000 in the amount of Reserve bank credit in use to $1,988,000,000 on May 18, the highest since the year-end. While part of this increase was offset by a loss of $200,000,000 in gold for export during the period and a slight rise in money in circulation, nevertheless there was a net increase of $280,000,000 in the volume of member bank reserve balances available for use as a basis of credit.

As a consequence of this increase, member bank reserves are estimated at the present time to be more than $300,000,000 in excess of requirements, sufficient at the customary ratio of expansion to support an added volume of member bank credit equal to over $3,000,000,000 without another dollar of credit expansion by the Reserve banks.

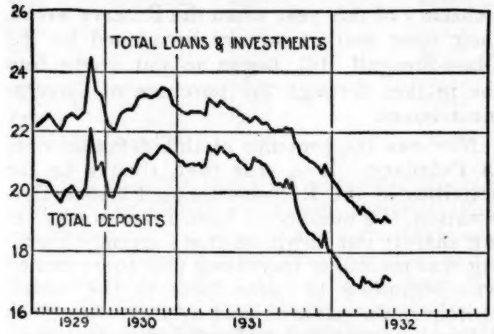
The Trend of Member Bank Credit

So much for the contribution of the Reserve banks towards business recovery. By their action, pressure of deflation due to monetary causes has been relieved and funds have been made available for member banks and business to use at such time as inclination and opportunity exist to use them.

But business, in the last analysis, can be benefitted by easy money policies only insofar as they lead to an expansion of member bank credit. In this respect the showing to date has been less impressive than the accomplishments recorded with respect to the Reserve banks.

Nevertheless, important progress has been made. The catastrophic decline in bank credit in progress since last July has been arrested. This is shown by the accompanying diagram comparing the course of total loans and investments and total deposits of the weekly reporting banks since last Summer.

The turn has been most marked in the case of deposits, which reached a low point of $16,837,000,000 in March and have since recovered to $17,128,000,000. For deposits to precede loans and investments in the turn is, of course, natural, since the injection of Federal Reserve funds into the market automatically swells the volume of deposits, while the movement of loans and investments depends upon the rapidity with which the funds are invested. It is evident from the course of total loans and investments that these funds have not been invested freely, but here too, within the past month, there has been a distinct tendency for the precipitate decline to flatten out.



All Reporting Member Banks
Total Loans & Investments and Total Deposits
Billions of Dollars

A clearer picture of what is taking place can be had if figures for New York City are separated from those for the rest of the country. Since open market operations are so largely carried on in the New York market it was to be expected that any expansion of credit would first manifest itself there, and that there might be a lag for the rest of the country. The accompanying table, comparing the changes in total loans and investments and total deposits for New York City and all other reporting banks between February 24 and April 13, which included the first phase of moderate Government security purchases by the Reserve banks, and between April 13 and May 18, which included the second phase of greatly accelerated buying, shows this to have been the case.

Weekly Reporting Member Banks

	Change in Period: Feb. 24 to Apr. 13		Change in Period: Apr. 13 to May 18	
	Million Dollars	Per Cent	Million Dollars	Per Cent
Loans & Investments:				
New York City....	—124	—1.9	+184	+2.8
All Other	—424	—3.2	—205	—1.6
Total Reporting..	—548	—2.8	— 21	— .1
Deposits:				
New York City....	+140	+2.5	+228	+4.0
All Other	—187	—1.6	— 34	— .3
Total Reporting..	— 47	— .3	+194	+1.1

It will be observed that in the case of deposits, figures for New York City banks gained

substantially both in the period from February 24 to April 13 and in that from April 13 to May 18, while figures for all other reporting banks showed a further slight drop in the first period but were practically unchanged in the second. In the case of loans and investments, the figures for New York City declined in the first period, but showed a substantial rise in the second, while those for all other banks declined in both periods, though at a diminishing rate.

Thus far such increase as has occurred in total loans and investments has been solely in the investment item, which has increased in the case of the New York City reporting banks. Loans, both for New York City and for the rest of the country, have continued to decline. Like the tendency for an upward turn in credit to manifest itself first in New York and later spread to the rest of the country, so it is in line with precedent for investments to be the first to reflect the influence of accumulating funds, the rise in loans coming at a later period of the upward cycle.

Putting the Funds to Work

The fact that the new Federal Reserve policy has not done more to stabilize prices and stimulate business revival has undoubtedly disappointed many people who expected too much within a limited period. Such disappointment should not obscure the real accomplishments of the policy, which have been described in preceding paragraphs and are important. The pressure imposed upon bank credit has been lifted, and funds are once more accumulating in large volume, awaiting investment in industry, agriculture and trade.

It remains now to find means for putting these available funds to work. To this end the principal obstacle now is fear. Manifestly it is the general view of business men that the uncertainties in political and financial affairs call for policies of caution with respect to forward commitments, and deferment of plans for new or replacement projects, and for expansion of operations, until their profitableness is more clearly assured. Among investors this attitude has its counterpart in avoidance of risk in the markets. Hence there is little show of initiative or enterprise in business, capital investment continues nearly at a standstill, and activity is largely confined to supplying daily needs which are reduced for lack of purchasing power to satisfy them.

Never has there been a clearer demonstration of the part that the accumulation of capital, and its transformation into buildings and machinery and other facilities for raising the standard of life, plays in normal business activity. Every promise of sustained improvement in the industries making goods for personal consumption has failed of realization because supporting improvement in the "capital goods" industries has not occurred.

Of course, it can be said that the country is over equipped and that capital investment therefore is not needed, but this is only a half truth, in view of the scrapping that is going on, the mounting obsolescence of the equipment in place, and the new methods, new products and new machinery with which industry needs to equip itself to meet changing markets and to keep production costs down. It is more in accord with the facts to say that the barriers to undertaking work of this kind are the unwillingness of the industries to engage in it while they are having difficulty in making both ends meet, and the unwillingness of investors and lenders to incur risk in industrial undertakings. Both policies are rational ones, and in light of all the circumstances are not properly subject to criticism, since the critics could not act differently if they had the decision.

Criticism of Bankers

There has been much criticism of the banks for failure to pass the new supplies of credit into use more rapidly. It is represented that after receiving great sums from the Reserve banks and the Reconstruction Finance Corporation the banks are as unwilling to make loans as before and in fact are the chief of hoarders. This is a kind of criticism that readily passes current, but it is unfair and inconsiderate of the difficulties of the banking situation. The new credit which is put into the market by Reserve purchases of Government bonds comes to the banks as deposits made by the public, and the banks are under the same obligation to handle them safely as in the case of other deposits. It should be understood that the business houses well supplied with capital generally are in easy circumstances now because of slackened trade and are not desiring to borrow. It is safe to say that the banks welcome opportunities to employ their funds safely. Unfortunately, after the losses of the last two years, many would-be borrowers formerly classed as good no longer are entitled to that rating. They are in need of reenforcements of capital before applying for loans of bank credit. This is always the case after every great shrinkage of values, and the principles of sound banking cannot be disregarded at any time.

As to purchases of securities similar comments are appropriate. The banks are necessarily cautious about individual purchases of bonds of the class for which the market at present is narrow, for they cannot disregard the possibility that it may be necessary to convert them back into cash. Always the banker must consider his obligation to the depositors whose money he is employing.

These considerations are not offered as arguments against further expansion of loans or purchases of securities, but in justice to the banker's side of the situation. It probably is possible for the banks to move more freely in concerted action than they have done singly, but time is required for the development of this policy. The organization in the several Reserve districts of Committees, composed in part of bankers and in part of industrial leaders, for the purpose of advising how funds may be safely used, is a further development of the Reserve policy and is sound in principle. This is a constructive effort to revive employment, and with the organization extending over the country should answer the complaint that credit is locked up in the centers.

It must be considered that the paralysis of individual initiative, distrust of credit and fear of the future extends over the whole world. Its effect is to produce a disintegration of organized society. It is as infectious as the most insidious disease, and is in fact a disease of the higher civilization, wherein credit has been long used with increasing efficiency, and finally, under the enormous stimulus of war and post-war conditions, recklessly. The reaction has been terrible, but all reactions spend themselves at last. People do not remain in the fear paralysis forever. Gradually they realize that all of the elements necessary to orderly business and prosperity still exist and that only a sensible policy of cooperation is needed to restore confidence and reestablish the economic organization in full working capacity.

The Part for Governments to Play

In large part the situation is the outcome of delay in this country and in others also in dealing with problems which have passed beyond the control of business men and become governmental problems, and action upon which has become more vital as attention has centered more on them, making them keys to confidence. Within the next few weeks decisions will be reached in Washington on the Government's fiscal policies and at Lausanne upon reparations and perhaps upon other critical matters. In their effects upon the will to spend and invest these decisions will be of greatest consequence in the outlook for business.

For the United States, and indeed for all countries, the establishment of the national finances on a sound basis is a condition essential to economic recovery. This means balancing the budget, both by courageous and patriotic action in rigidly controlling expenditures and by increasing the revenues through a broadening of the basis of taxation. The present fiscal year which closes June 30, 1932 shows a deficit through May 24 of approximately $2,655,000,000, of which $486,000,000 represents appropriations for the Reconstruction Finance Corporation and $382,000,000 purchases for the sinking fund. Estimates that have been prepared for the 1933 fiscal year indicate the need for raising approximately $1,100,000,000 in additional revenues and effecting a reduction of $300,000,000 in Governmental expenditures in order to bring receipts and expenditures into balance by June 30, 1933. This calculation includes as revenue $270,000,000 due from foreign governments which may not be received, relies upon some increase of revenues due to an upturn in general business, and does not include such appropriations as may be necessary for the Reconstruction Finance Corporation. The task of Treasury financing during the coming fiscal year, in view of the uncertain balance of the budget, is a problem that demands attention before consideration is given to the various relief proposals calling for the additional expenditure of several billions of dollars.

Without assurance of Government determination to keep its fiscal house in order there can be no real confidence in the monetary system or security in any investment or business program. It is safe to say that no single influence has done more to unsettle confidence, check business revival and offset the good effects of the Federal Reserve credit expansion program than the delay on the part of Congress in dealing effectively with this issue. It is an important and hopeful fact that the Washington observers uniformly predict defeat of the various proposals that would lead to currency inflation, and the passage of tax and economy bills that will bring the Federal budget into balance, according to the Treasury estimates.

General Business Conditions

The month of May has not been an improvement over its predecessors, so far as general trade activity is concerned. Some of the industries have shown an upturn in the nature of a belated "Spring rise," but distributive trade has been dull, and such broad indexes of activity as car loadings and electric power production have made an unfavorable showing, running farther below the corresponding weeks of 1931 than in any earlier period this year. Moreover, weakness in the security and commodity markets has contributed its quota of disappointment to the situation, indicating little confidence in early business revival.

The most encouraging development in industry during the month is the belated expansion in automobile manufacture, which has provided support for the steel industry against the falling off in demand from its other customers. The seasonal peak of automobile sales and production is generally reached in

April or about the first of May, and in the high and medium priced cars the trend has been about as usual, and is now downward. But in the lower price ranges the situation has been different. Due to the late introduction of the Ford model the Spring sales for all makes came late and the production peak has not yet been reached. After making 115,000-120,000 cars in each of the first three months of the year, the industry turned out 148,000 in April, apparently came close to 200,000 in May, and with further expansion by the Ford Company it appears certain that June will bring another gain.

Of course, the figures are very low and it is necessary to go back to 1921 for comparable totals, but the gain is helpful in many directions. It is due to automobile orders that operations of the steel mills increased gradually from the April low point of 21 per cent to 25 per cent in the third week of May, according to the estimates of the Iron Age.

Building construction is extremely slow but has likewise shown somewhat more than the usual seasonal expansion. Contracts awarded through the 21st of the month, according to the F. W. Dodge Corporation, averaged $5,319,000 daily, an increase of 13.6 per cent from the April average, although a decline of 56.6 per cent from one year ago. For this moderate gain public works construction, especially of highways, has been entirely responsible, since new residential building is more nearly at a standstill than for many years back.

The foregoing are three very important industries and even the moderate improvement noted is an encouraging one. The question of the "minimum" to which business can drop is sometimes raised, and the course of these industries seems to supply some evidence on the matter; at any rate they have now held their ground or gained slightly for several months, without the aid of general business or trade recovery.

In other lines the recent trend has been of disappointing character. The textile industries in particular have been dull. The cotton mills during March and April sold only about one-half of their production and a sharp curtailment of operations has followed. Domestic cotton consumption in April showed one of the severest declines on record, the average per working day dropping to 15,600 bales compared with 19,600 in March. Apparently the mills have not sold their output during May and continued curtailment into the late Summer is in prospect. Woolen goods business for Fall has not yet developed to any extent, although several weeks have elapsed since the manufacturers offered their Fall lines and prices are substantially lower. In the rayon industry a complete shutdown in June is talked of, to permit absorption of stocks on hand. The silk goods season has not been a favorable one and the hosiery mills are operating at a very low figure. Shoe production likewise is curtailed, the April total being estimated at 26,500,000 pairs compared with 29,900,000 in April last year.

The Course of Prices

The month has been another trying period in the markets. Declines to new lows in stocks, bonds and commodities have both reflected and caused discouragement and have created further difficulties for business. The fall in commodity prices has been a slow one, but has centered in the raw materials and farm products which already had declined more than manufactured articles, and the price disparities which are disrupting the exchange of goods therefore have not been improved during the month. Among the commodities which reached new lows during May are copper, zinc, silk, wool, hogs, steers, pig iron, sugar, rubber, butter, and vegetable oils.

An exception to the general weakness, and a very important one, is wheat. The Government estimate of the winter wheat crop as of May 1 was 441,000,000 bushels, a reduction of 17,000,000 as compared with one month earlier, and 346,000,000 under last year's yield. Private reports during the month have indicated a further decrease. The Spring wheat prospect is a more favorable one. Planting has made good progress and moisture conditions are more satisfactory than in several years. Even if the Spring wheat crop should be a good one, total production will be little if any above domestic requirements, and exports will come out of the carryover.

The acreage in Winter wheat in twenty countries, including Russia, is estimated by the Department of Agriculture to be 5,300,000 or 3 per cent less than one year ago. The Canadian Spring wheat area is reported decreased 3.5 per cent, but planting is off to a good start. In view of the part that wheat has frequently played in leading the way out of depression, the situation will bear watching, for the ground is laid for an important advance in prices if there should be crop failure in any of the principal Spring wheat producing areas of the world.

The cotton crop is getting a good start with weather generally favorable and the acreage reduced less than the trade would like to have it in view of the excessive carryover from the present crop. However, the last word is not said upon the cotton yield until the boll weevil has had its chance at it, and the crop this year is very inadequately fertilized.

The prospect for agriculture is not a cheerful one in view of the prices of agricultural products, but is helped by the tendency of

farmers everywhere to grow more of their living at home and to use more "family labor." Farm wages have continued downward in a season when they ordinarily advance. The economies that are being made in the cost of production will stand the farm areas in good stead when the time comes to market the crops next Fall.

Money Rates and Gold Movements

The continued piling up of funds in the chief money centers, through the Federal Reserve Bank operations already discussed in this Letter, has further eased the money markets, and additional reductions in short term loan and investment rates have occurred during the month. Compared with April 1, prior to the expansion of the Reserve Banks' security buying program, the rates prevailing at the end of May were as follows:

	April 1	May 25
Call Money	2½	2½
Time Loans, 60-90 Days	2¾ — 3	1½
" " 4, 5, 6 Months	2¾ — 3	1½
Commercial Paper, Best Names	3¾ — 4	2¾ — 3
Acceptances, 90 Days, Asked	2⅛	⅞
Treasury Bills	1.90 @ 1.70	.35 @ .15

As the banks have faced increasing difficulty in employing all their funds at remunerative rates, it was inevitable that rates of interest paid on bank deposits should come down also. Effective May 13 the New York Clearing House reduced rates which its members may pay by ½ of 1 per cent, making the new rates ½ of 1 per cent on demand deposits payable to banks and individuals (except mutual savings banks for which the rate is 1 per cent), and 1 per cent on time deposits. This reduction restores the rates effective from May 18 to October 16 last year; however, the ruling of the Clearing House put into effect April 22, providing for deduction from the balance on which interest is figured of a sum equal to the reserve requirement against the amount, was equivalent to a lowering of the rate paid, and therefore the new rates are actually the lowest ever fixed by the Clearing House, and represent 0.435 per cent on demand deposits figured on the old basis.

This action was followed by a cut in the rates on foreign deposits, reducing them to ½ of 1 per cent on commercial demand deposits, 1 per cent of demand funds of central banks, and 1½ per cent on time deposits.

The reduction in Clearing House rates is not only a consequence of the Reserve Bank policy, but is calculated to assist in making it effective, since the low return on balances in the larger centers supplies an increasing incentive for country banks to use their funds at home even at somewhat greater risk. Thus the change will be a factor in spreading cheap money from the New York market over the country.

The Gold Shipments

Another of the "inflation scares" concerning the dollar which appear to develop periodically in Europe has been in full swing during May, causing the heaviest withdrawals of gold in any month since October. Through the 27th of the month the net loss had been $205,500,000, the changes consisting of exports of $205,000,000, an increase of $13,300,000 in earmarkings, and imports of $12,800,000. Nearly all of the exports went to Holland, France, Switzerland and Belgium, in that order, and the exchanges of all those countries throughout the month have been at or close to the point making gold shipments profitable.

These shipments are the expression of a continuing desire of people in other countries to have their funds at home, following their experience with balances in London on which losses were incurred when gold payments there were suspended. The withdrawals are regarded in this country as a desirable repatriation of the foreign owned gold which was attracted here by high interest rates during the boom and which has been an element of danger and unsettlement while it has been here. Of course, it is regrettable that the movement is of a partly hysterical character, due to misunderstanding abroad of the measures adopted for relieving the credit situation. The withdrawals have caused no disturbance in the money markets, the Reserve Banks having offset them by purchases of securities.

A slight increase in currency in circulation has occurred during the month, the net gain having been $12,000,000 in the four weeks ended May 25. If this indicates resumption of hoarding it is obviously of minor importance. Evidently the apprehensions of Europe over our monetary standard find little echo here. Bank failures, which are the primary cause of hoarding, continue much less numerous than in the Winter. They totaled 45 in March, 68 in April, and 67 in May up to the 26th, according to the American Banker.

The Bond Market

The bond market has continued under pressure of discouraged selling during May. Losses in the lower rated issues of all types have been particularly severe and in numerous cases prices have dropped to the lowest ever recorded. Higher grade bonds have held their ground better, but have declined likewise. After the middle of the month the Government issues developed considerable weakness, and the Treasury 3s of 1951-55, which at the first of the month were quoted above 94, sold for a time below 90.

The influences operating in the market are not difficult to trace. Weakness of Govern-

ment bonds undoubtedly reflects the apprehension in the minds of investors caused by the long delay of Congress in enacting tax legislation and in effecting economies to balance the budget, as well as the proposals for relief expenditures calling sooner or later for further large offerings of new securities by the Treasury. Inasmuch as the trend of Government bond prices dominates the market for the highest grade bonds of other classes, the latter have declined in sympathy, although current money rates make the yield of such bonds attractive and the banks on the whole have been buyers instead of sellers, the "investments other than Governments" of the weekly reporting member banks having increased $16,000,000 in the first three weeks of the month. Among the groups rail bonds have been weakest and the high grade municipals and utilities strongest.

For the virtual collapse in prices of the second and third grade issues, the explanation is the persistent liquidation by holders who have lost confidence in the ability of the obligor corporations to maintain payments, or who have become alarmed and sold merely because other people were selling. There are many issues, amply protected by underlying liens on valuable property, which are selling below any price to which they would likely be scaled down in receivership. In the present state of the market, however, such considerations are less regarded than the panicky fear that prices may go lower.

New bond issues have continued negligible in amount. Only one corporate issue, of $1,000,000 public utility bonds, was offered last month through the 27th, while state and municipal issues totaled $70,000,000.

U. S. Government Financing

New offerings of short term securities by the Treasury have continued heavy but have been oversubscribed and sold at artificially low rates because of the surplus of banking funds in New York and the other money centers brought about by the aggressive open market policy of the Federal Reserve Banks. Five issues were offered during the month, on which the subscriptions, the allotments and the average interest rates were as follows:

Treasury Offerings, May, 1932
(In millions of dollars)

Type of Security	Issue Date	Due Date	Subscription	Allotments	Ave. Int.
Certificates	May 2	May 2, '33	$1,700	$239	2.00
Notes	May 2	May 2, '34	2,496	244	3.00
Bills	May 11	Aug. 10, '32	352	77	0.68
Bills	May 18	Aug. 17, '32	395	75	0.43
Bills	May 25	Aug. 24, '32	335	60	0.29
Total			5,278	$695	

The extreme disparity between yields of 6 per cent and upwards for corporation bonds of good standing and the sale of Treasury bills at the low record of 0.29 per cent is a striking characteristic of the times, illustrating the lack of confidence in the bond market on the one hand, and on the other the abundance of funds available for riskless short term employment, regardless of the interest rate.

Although part of the Treasury offerings are for the refunding of maturing obligations and therefore represent no demand for new capital, the larger portion is not thus offset, as may be seen from the following summary of security offerings for the first five months of 1932 and of fixed maturities during the same period, the balance representing new capital:

U. S. Treasury Offerings and Maturities
(In millions of dollars)

Month 1932	Total Offerings	Maturing Issues	Increase In Debt
January	$ 101	$ 103	$ 2*
February	587	271	316
March	1,227	826	401
April	203	101	102
May	695	215	480
Total	$2,813	$1,516	$1,297

* Decrease.

It will be seen that of the borrowings by the Government since the beginning of 1932, represented by thirteen issues of Treasury bills, six of Treasury certificates and one of notes, making twenty issues totaling $2,813,000,000, the sum of $1,516,000,000 was applied to the refunding of maturing issues while $1,297,000,000, or nearly one-half, constituted an increase in indebtedness. This increase nearly offsets the drop in other public offerings from $1,971,000,000 in 1931 to $561,000,000 this year.

It is an interesting speculation, though an idle one, what the effect upon business would have been if these funds had remained available for industry and if confidence had been upheld by a balanced budget. Surely the situation today would be a very different one, and far less troublesome.

World Trade in the Depression

Current figures of the foreign trade of the principal countries show in impressive manner the severity of the decline in world trade that has occurred since 1929, and the significant changes in the trade positions of different countries that have been caused by shifts in capital movements, currency depreciation, tariffs and other obstructions, and similar influences characteristic of the present disordered state of affairs. The accompanying table gives the combined trade of twenty-three countries for the first quarter of this year (for four months where available) with comparisons going back to 1929, and also for the past three calendar years. These countries do more than 80 per cent of world trade, and the value of their current trade is only 41 per cent

of the 1929 figure, and the lowest in twenty years or more.

Foreign Trade of 23 Countries
(In millions of dollars)

First Quarter*	Exports	Imports	Per Cent Total Trade is of 1929
1932	3,135	3,542	41
1931	4,682	5,364	61
1930	6,671	7,558	87
1929	7,709	8,588	—

* Four months for 8 countries.

Calendar Year (25 countries)	Exports	Imports	Per Cent Total Trade is of 1929
1931	14,907	16,633	57
1930	20,845	23,045	79
1929	26,503	28,855	—

The decline in trade has been a cumulative one, operating in the manner of a vicious circle, and no country is exempt. Difficulties were experienced earliest and most acutely by the raw material producing countries, notably in South America and Australia. Their exports were reduced and loans to them ceased, correspondingly reducing the amount of foreign exchange available to them for purchasing and for making payments abroad on their indebtedness. There followed in sequence exports of gold, sharp declines in the exchange value of currencies, and in some cases default on their international obligations.

For these countries there has been but one way out. Whatever the decline in the value of their exports, they have had to reduce their imports more, in the effort to bring their international payments into balance. Since their imports are the exports of other countries, the vicious circle was thus set going.

Effects of "Confidence Crisis"

In the early part of the depression inter-European trade was affected less than any other, but the worst blow to world trade was to come from Europe. This was the "confidence crisis," which originated in Central Europe one year ago. The sudden flight of short term capital, when alarm as to its safety spread over the world beginning with the Credit Anstalt difficulties, required overnight payments far beyond the capacity of normal trade balances to make, and set in motion the events which have done the most to reduce trade to the present chaotic condition. The gold and foreign exchange available for making the payments was quickly reduced to the minimum needed as currency reserve, and thereafter the necessary exchange could be obtained only out of an export trade balance. Hence the forced curtailment of imports and effort to maintain exports at all costs. In part the process has been an automatic one, since the loss of bank reserves exerted deflationary effects on commodity prices and values of all kinds, making the country a cheaper market to buy in but a poorer one to sell to. The process has been hastened by governmental policies limiting imports or giving inducement to export.

This was the sequence of events in Germany and the other Central European countries. Finally Great Britain was involved, the depreciation of sterling affording a temporary stimulus to exports and an obstacle to imports, to which the protective tariff policy is added.

Accompanying all these developments has been a mounting tide of trade restrictions. First against pressure to sell German goods and then against British goods drastic tariff measures were instituted. Various countries have established quota systems, limiting certain imports by volume or value to specified quantities from specified countries. The license system is much the same in effect, being a substitute for fixed quotas. Embargoes are not unknown. Control of foreign exchange is a transitional measure adopted of necessity by many countries to prevent flight of capital and to preserve the value of their currency, and acts effectively in restricting imports, since importers can obtain means of payment only from the government or central bank.

Changes in Trade Balances

The following table brings out the changes in the trade balances of the nations, the causes of which have been given in the foregoing discussion. The seventeen debtor countries in the table converted an excess of imports of $117,000,000 in 1930 into an export excess of $765,000,000 in 1931, and thus far this year have had an export balance of $148,000,000 compared with $67,000,000 in the same period last year.

Excess of Exports (+) or Imports (—)
(In Millions of Dollars)

Creditor Countries	Full Year 1929	1930	1931	First Quarter 1931	1932
United States	+ 842	+ 782	+ 334	+171*	+ 72*
Un. Kingdom	—1,879	—1,888	—1,828	—586*	—350*
France	— 322	— 378	— 461	—173*	—124*
Netherlands	— 306	— 281	— 233	— 81*	— 73*
Switzerland	— 116	— 151	— 174	— 36	— 46
Belgium	— 102	— 129	— 16	— 11	— 12
Sweden	+ 8	— 28	— 80	— 27	— 6
Denmark	— 22	— 15	— 33	— 6	— 5
Total	—1,897	—2,083	—2,491	—749	—554
Debtor Countries (Industrial & Semi-Industrial)					
Germany	— 174	+ 223	+ 591	+109*	+ 89*
Japan	— 30	— 38	— 42	— 41*	— 71*
Italy	— 339	— 275	— 83	— 37	— 27
Czechoslovakia	+ 16	+ 53	+ 41	+ 14	— 3
Austria	— 152	— 120	— 120	— 36	— 29
Poland	— 34	— 19	+ 47	+ 7	+ 8
Canada	— 117	— 122	— 27	— 51*	— 13*
Norway	— 86	— 102	— 99	— 16	— 5
Total	— 916	— 362	+ 308	— 45	— 51

Debtor Countries
(Primary Producers)

	Full Year 1929	1930	1931	First Quarter 1931	1932
Argentina	+ 88	— 103	+ 77	+ 11*	+ 66*
Brazil	+ 40	+ 59	+ 101	+ 21	+ 21
Chile	+ 82	— 8	+ 27	+ 1	+ 7
China	— 160	— 191	— 165	......	......
British India	+ 294	+ 264	+ 109	+ 26	+ 20
D. E. Indies	+ 158	+ 158	+ 96	......	......
So. Africa†	+ 69	+ 91	+ 87	+ 25	+ 47
Australia	— 106	— 41	+ 120	+ 30	+ 40
Hungary	— 4	+ 16	+ 5	— 2	— 2
Total	+ 461	+ 245	+ 457	+112	+199

*—First 4 Months. †—Includes Gold.

Germany converted an import balance in 1929 into an export balance of $591,000,000 in 1931 not including $100,000,000 reparations paid in kind, and for four months took rank over the United States as the leading exporter in the world. The gain was too great to last, since relatively high imports are necessary to give Germany the materials to manufacture for export, and her efforts to sell abroad have met more vigorous competition from Great Britain, and have had to overcome tariff increases and other obstructions placed in her way. Therefore her export balance during the first four months of this year was less than one year ago.

Other countries which have converted import balances into export surpluses are Argentina and Australia, while import balances have been nearly wiped out or greatly reduced by Canada, Italy and Belgium.

Particular interest attaches to the figures for Great Britain. Her import merchandise balance before the war averaged about $800,000,000 annually, and in recent years has exceeded $1,800,000,000. As the event has shown, the balance was too high for her to meet continuously. With sterling depreciated and the protective tariff in force her import balance already has been reduced, and for the first four months this year totaled $350,000,000 compared with $586,000,000 in the same period of 1930.

Significance of the Figures

What is the significance of these figures? Clearly the changes in the trade balances of the debtor countries have been inevitable. With countries, as with individuals, there is no other way to economic rehabilitation after a period of excess than that of self-denial and intensified effort, leading back over a difficult road to balanced exchanges once more. Until payments are balanced the trade restrictions enforced by these countries are not likely to be lightened, and there can be no resumption of international credit operations, which more than any other agency would be helpful to recovery. Hence there is encouragement in the progress made toward a better balance of merchandise trade, usually the largest item in the total balance of payments.

However, the countries which have made progress are not prospering, and the effects of the situation on the whole are very unfavorable. Obviously it is impossible for every country to "improve" its trade balance, and to the extent that some countries succeed in doing this others are forced to adjust themselves to smaller "favorable" balances or larger "unfavorable" balances, as the case may be. The creditor nations, which ultimately receive the payments made, are the ones affected. The table shows that the export balance of the United States has dwindled steadily, and the import balance of France increased until "quotas" were put upon imports, which have reduced the import excess this year as compared with previous years.

The effort of the debtor countries to export results in dumping on foreign markets, which has been destructive of price and has tended to further disorganize trade, and defeats the purpose of the exporter to obtain more foreign exchange. A recent report of the League of Nations, for example, pointed out with respect to Bulgaria that although her exports in 1930 increased 80 per cent in volume, they declined 3 per cent in value. In 1931 a further 40 per cent increase in volume occurred, but value declined 4 per cent more. The figures are similar elsewhere, and for Argentina the "Review of the River Plate" characterizes the situation as a liquidation "dangerously unfair and murderously disadvantageous to the country."

Nor is the reduction in imports to the minimum of subsistence requirements, which alone has made possible "improvement" of trade balances in the face of declining export values, any more a natural or healthy one. People are being forced to go without not only luxuries but in many cases necessities. Evidence of social unrest in many countries which have cut imports most drastically is proof of the discontent of the people under deprivation.

Undoubtedly the pressure on commodity prices has arisen in great extent from the effort of all countries to sell more and buy less on the international markets.

The Danubian Situation

The most critical situation created by disruption of trade is the Danubian situation. The old Austro-Hungarian Empire, although racially a patchwork, was economically a balanced state existing upon a diversified production and mutually advantageous exchange of products. The parts of the Empire that are now in Hungary, Rumania and Jugoslavia were predominantly agricultural and Austria and the present Czechoslovakia were the manufacturing sections. Each section produced what it was best fitted for and each complemented the other, all exchanging to the profit of all.

The erection of new political boundaries in this area of course did not alter the soil, climate, location of materials, abilities and training of the people or the other factors which had determined what each section could economically produce, but the policies of the new governments have been in the direction of self-sufficiency and aimed at overcoming such factors rather than deriving benefit from them. The fact that the existing industrial plant was sufficient for the supply of the agricultural countries was ignored by them because the plant was now within another political boundary; and the farming countries set out to build factories and the factory countries to stimulate farming. Before the separation Hungary milled wheat for the Empire, but the other states set about building mills to be rid of dependence on Hungary. Hungary doubled its spinning and weaving plant in order to buy less from Czechoslovakia.

Austria, an industrial country now bereft of its market, has tried through subsidies to build up agriculture in the unsuitable Alpine regions. The agricultural states, with conditions unfavorable to industry, inadequate transport facilities, and skilled labor lacking, have been building factories, naturally providing high tariffs to keep them going. According to the International Chamber of Commerce the tariffs of the Danubian countries one year ago averaged nearly double those of most of the Western European countries.

In all this there was insufficient consideration of the matter which is responsible for much of the present difficulty, namely, the wasteful cost of the duplication of factories, agricultural activity and banking in the region where the old state of affairs was working very well. It is said that plants had to be abandoned and the investment in them lost while similar plants were built only a few miles away, but across a new border. Of course this duplication could not support itself and the local industries with few exceptions had not developed real strength when the depression began. Nor had any country approached in measurable degree its goal of self-sufficiency, or even altered the broad character of its trade. The farm countries continue to export farm products and import manufactures, and vice versa. Trade still dovetails, but with the great difference that all trade is restricted and hampered, the cost of living is raised and the standards of living are lowered. Moreover, a smaller percentage of their trade is with each other, and more with other countries, an uneconomical condition.

For these countries the problem of making payments on indebtedness due abroad has been extremely difficult. As the other debtor countries to which we referred have done, they have sharply reduced unfavorable balances of trade by restriction of imports, but total trade is now so small in relation to their debt that their difficulties are acute. Thus Hungary, already under a moratorium, with debt service of approximately $50,000,000 annually had total exports of only about $100,000,000 in 1931 and an export trade balance of only about $5,000,000.

Troubles Aggravated by Trade Obstructions

The following extract from a report to the Department of Commerce concerning Hungary shows how other difficulties have been aggravated by the trade restrictions:

> **All of Hungary's principal foreign markets are restricting imports of agricultural products, especially livestock, which during the last two years has been Hungary's most profitable class of exports. The outlook for livestock exports is very discouraging. Austria, Italy and Switzerland, Hungary's three most important markets for cattle, are curtailing imports further through reduction of quotas. Hog exports are suffering, owing to the rise of hog prices in Hungary occasioned by the failure of the corn crop and the necessity of importing feedstuffs. Sheep exports were recently menaced by Swiss veterinary measures, and by the establishment of a quota by France limiting Hungarian slaughtered sheep to only 24,000 head and live sheep to a very small number for 1932.**

Restriction of imports by Austria has fallen with great effect upon other countries. According to the Vienna correspondent of the London Statist, importers of Austria during April were allotted only 1½ per cent of the foreign exchange for which they applied. The Austrian Government has published a list of about fifty items whose importation will require the special permission of the Government. These items are not all luxury articles, but include cattle, calves and pigs, butter and lard, cotton fabrics, and chemicals. Manifestly these restrictions lead to lower living standards in Austria, and react elsewhere. The Budapest correspondent of the London Economist states that this decree has caused consternation in Hungary, that a new quota treaty with Austria will be necessary and there is little doubt that it will result in a further strangulation of trade.

Further illustrations could be employed, but the nature of the situation is well understood. The Western European powers and the League of Nations are endeavoring to assist in it, but the economic and political interests in the area diverge and they have found no basis for agreement upon helpful action, the London conference in April having adjourned without a date for reconvening. Nor have the many proposals for economic union made progress among the States themselves.

It will be recognized that the greatest trouble of the Succession States is the world depression, and that is true of the decline in all trade, but there is a lesson of the effect of past and present trade interference in bringing

on and intensifying the depression. It is often said that tariffs themselves are not objectionable, but only tariff changes, since trade will adjust itself to tariffs and will go along if not required constantly to make fresh adjustments. But this argument overlooks the fact that where trade obstructions are employed to seek advantage there will always be others in reprisal, and while rivalry between nations is expressed in tariffs there is no reason to believe that a state of rest will ever be reached.

The prospect for sweeping reform in world tariffs is not a hopeful one, but improvement may begin by regional agreements and manifestly the Danubian area is a logical place to begin.

Necessity for Trade

It is a matter of grave concern that the tariff situation should have grown worse in a time when trade is so little able to bear the burden of tariffs and when the fullest possible flow of trade was never so badly needed. The nations and people of different nations have obligations to each other which require the transfer of goods between them, and when the transfer of goods is obstructed the drain of gold and the consequent currency depreciation and monetary disorder are correspondingly more severe. It would be to the advantage of the creditor nations if they would recognize this phase of the situation.

Grants of credit from creditor to debtor countries would go far to keeping trade in equilibrium, but present conditions do not permit this solution. International lending is recognized by all authorities as essential in international trade, and it was the opinion of the eminent economists who prepared the MacMillan Report that "the debtor countries probably require amongst them new loans from the creditor countries in the aggregate of not less than £400,000,000 per annum in normal circumstances, unless the creditor countries increase their imports relatively to their exports as compared with what they were before the commencement of the world depression". In brief, creditor countries must either lend or buy.

With all the progress made in facility of transportation, communication and physical conduct of business, surely the policies of the nations are responsible that the trade between them has dropped off to what it was twenty or more years ago. Those who have advocated each country being self-sufficient may be satisfied with this showing, but manifestly the general well-being has suffered by it, living standards have been lowered, and the depression prolonged.

The supreme need of the times is that the nations shall accept their common responsibility for the situation, and deal with it in a spirit of concession and mutual adjustment. The doctrine of self-sufficiency is influencing their policies to a degree never before known, and present conditions give evidence that the benefits to any one are illusory to the last degree, since to all the effect is impoverishment.

The Railroads

The continued low volume of railroad traffic since the first of the year has intensified the financial problems of the railroads, causing a decline in revenue that has more than offset the benefits of the emergency increase in freight rates effective January 1 and the 10 per cent wage reduction effective February 1. Assistance in meeting their obligations has been required by a number of roads, and has been supplied by the Reconstruction Finance Corporation, which up to May 27 had approved loans aggregating $167,207,043 to thirty-eight roads.

Railroads represent the largest American industry and investors hold their obligations more widely than any other securities except those of the United States Government. There were over 840,000 shareholders listed on the stock registry books of the railroads at the end of 1929, and since that time the number is believed to have been increased substantially. Of the $11,046,000,000 bonds and notes outstanding at the beginning of the year, more than 70 per cent is owned by the banks, insurance companies and other institutions and thus represents the savings, investments and insurance of the American people. For this reason, the emergency steps which have been taken to maintain the solvency of the railroads, and the further measures that have been proposed to restore the industry to a more prosperous state, are matters of the most vital public interest.

Loans by the Reconstruction Finance Corporation

The advances of Government funds to the railroads through the Reconstruction Finance Corporation are sometimes thought of as representing subsidies or donations, but such a view is entirely erroneous. Every loan requires the submission of an application setting forth in great detail the financial condition of the company, the purpose for which the loan is desired, the collateral security offered, etc., and must be approved as to terms and conditions by the Interstate Commerce Commission in addition to the R. F. C. Six per cent interest is charged on these loans, which is a much higher rate than that which the Government is paying for its own funds. In the case of a similar revolving fund set up by the Government in 1920 to aid the railroads upon their return from Federal control to private opera-

tion, the experience was not only satisfactory but profitable to the Government. Loans totaling approximately $351,000,000 were made to the railroads, of which $317,000,000 was repaid on account of principal and $88,000,000 in interest, leaving only $34,000,000 principal amount still outstanding.

In the matter of making loans by the R. F. C. to the railroads for the purpose of meeting maturing bank loans, there has been a certain amount of needless discussion due to a misunderstanding of the principles of the relief legislation, and of banking. Banks would be of small service to business and indeed could not operate if they did not turn over their funds frequently, meeting the temporary needs of business, but leaving the long-term borrowings or capital expenditures to be financed in the public capital market out of investment funds. Otherwise their resources would become tied up or "frozen."

On a smaller scale this occurs when loans become "slow," and the ability of the banks to meet demands for accommodation is weakened. The railroad loans became slow because there was no public market for the long-term obligations that had been expected to retire them. Certain of these loans were made or renewed by the banks solely to tide the railroads over until such time as the R. F. C. could be organized and begin to function. Passage of the Reconstruction Finance Act recognized this situation as an emergency making it desirable for the public credit to supplement private credit in carrying such loans, in order that private funds might be left free for use in the customary manner. In numerous instances the banks have agreed to share the burden by granting renewals to a portion of the loan.

A number of these loans by the R. F. C. were made on the condition that they would be repaid by the Railroad Credit Corporation, which would take over the loans as rapidly as funds were received from the pooling of the emergency rate increases. This latter corporation reported that up to April 30, 1932 it had made loans of $4,188,582 and authorized further loans of $14,492,577, giving a total of $18,681,159. Loans made by the railroads to one another are thus an offset to the loans made by the R. F. C., and the net amount of assistance extended by Government funds is probably less than commonly supposed. While the pooled proceeds from the increased rates are included as income in the reports of the individual carriers, they are not available in the form of cash to be paid out in meeting expenses of all the roads, but are loaned when needed to the companies not earning fixed charges.

Meeting Changed Conditions

The present low level of traffic and earnings does not indicate anything fundamentally wrong with the railroads, but is due primarily to the depression. Although a substantial amount of both freight and passenger business has been lost to motor trucks and buses, this has not been the major factor in the decline since 1929. In the 1931 annual report of the Southern Railway Company, for example, it was stated that in an effort to explain its decline in freight revenues in 1931 below the annual average of the preceding eight years an analysis was made by its traffic department as to the source of revenue during the period. This showed that approximately 70 per cent of the loss could be assigned to reduced activity in production and trade, with the remaining 30 per cent due to the competition of new agencies such as trucks, waterways and pipe lines.

Truck competition has been greatly intensified during the depression for the reason that drivers may be secured at low wages and there are no effective regulations as to length of time on duty, weight of load carried or rates charged. This condition places the railroads at a decided disadvantage, inasmuch as they are regulated in almost every conceivable particular. Legislation designed to correct this situation by providing for regulation of trucks so as equalize the rates and conditions under which they compete with the railroads is now being enacted in various States.

On May 23rd the United States Supreme Court handed down two important decisions, one of which involved the constitutionality of a law of the State of Texas limiting the loads and size of common-carrier, contract-carrier and private trucks, and the other a law of the State of Kansas imposing a gross-ton-mileage tax on all trucks, with certain exceptions. In both cases the Supreme Court unanimously upheld the validity of these State laws.

There is a very significant passage in the Texas case in which the Court, speaking through Chief Justice Hughes, stated:

> It is said that the exception was designed to favor transportation by railroad as against transportation by motor trucks. If this was the motive of the legislature, it does not follow that the classification as made in this case would be invalid. The State has a vital interest in the appropriate utilization of the railroads which serve its people as well as in the proper maintenance of its highways as safe and convenient facilities. The State provides its highways and pays for their upkeep. Its people make railroad transportation possible by the payment of transportation charges.
>
> It cannot be said that the State is powerless to protect its highways from being subjected to excessive burdens when other means of transportation are available. The use of highways for truck transportation has its manifest convenience, but we perceive no constitutional ground for denying to the State the right to foster a fair distribution of traffic to the end that all necessary facilities should be maintained and that the public should not be inconvenienced by inordinate uses of its highways for purposes of gain.

These two decisions will go far to clarify the present confusion now existing among the various State legislatures and in the State courts as to the constitutionality of various laws now in existence or contemplated, that have as their aim the regulation of the large amount of motor trucking that has become a problem in virtually every community.

Truck Operation by the Railroads

Some of the railroads have already established pickup and delivery service by trucks, adding the charges therefor to the station to station rate, and operate motor truck lines in the case of relatively short hauls and high priced or perishable commodities, coordinating this service with their regular long haul business.

In connection with these services, the suggestion was made by Mr. F. W. Sargent, president of the Chicago & Northwestern Railway, in that company's 1931 annual report that the Railway Express Agency, which is owned by the railroads, would be an ideal agency to handle all less-than-carload freight for the railroads as a whole, to operate trucks on public highways where they are more efficient and economical, and to handle the freight transfer and forwarding business in large cities and in terminals. A large volume of miscellaneous freight is now being collected by forwarding companies, which consolidate the freight into carload lots of the different classes, and thus secure the benefit of the carload rates. These companies are privately owned and are not under regulation by the I. C. C., so that they are free to take or reject any kind of freight they desire, to cut rates, grant rebates, and discriminate between shippers, all of which the railroads as common carriers are strictly prohibited from doing. Mr. Sargent proposes that the Railway Express Agency should be established as a consolidator and forwarder of freight at the earliest possible time and cites the following reasons:

(1) The Railway Express Agency, being national in its operations, could compete more successfully with the forwarders, which are now national in scope, than could any individual railroad.

(2) If handled by the Railway Express Agency, competition would not only be less severe, but the expense of operation would be much less than if the individual carries entered this field separately.

(3) It would recover to the railroads a good deal of traffic where the forwarder is using trucks instead of rail service.

(4) The added expense to the Railway Express Agency with its present organization would naturally be less than the expense to the company whose sole business is a forwarding and consolidating service.

(5) On account of the added volume of business to the Railway Express Agency, its unit cost would decrease, and in addition thereto, by the utilization of best located and most economical operating facilities and routes, it would obtain a maximum of net revenue from the operation.

(6) The revenues which are now enjoyed by the forwarding companies could be returned to the transportation companies, where they belong.

Other Remedies Proposed

Some of the other suggested remedies which call for action by governmental authorities or which the railroads themselves may take toward the further reduction of operating costs and fixed charges include the following:

Reduction of the excessive railway taxes, which in 1931 amounted to $307,000,000 and took 37 per cent of net railway operating income before taxes.

Repeal of the "recapture clause" of the Transportation Act of 1930 so as to permit the railroads to build up their surplus and reserves during years of good earnings.

Substitution for the present rule of rate-making, which is based on property valuations as of 1913 with adjustments for additions and depreciation and has proven unworkable, of a "rule of reason" based on the public need of adequate transportation service and the need of revenue sufficient to enable the carriers, under honest, economical and efficient management, to provide such service.

A more liberal attitude on the part of the Government toward consolidation on a broad scale of the large number of separate railroads into a smaller number of strong systems.

Relief from the heavy assessments for non-productive expenditures such as grade-crossing elimination. These projects yield no additional revenue to the railroads, and if they are considered desirable or necessary for the public safety their cost might properly be borne by the states and communities which are directly benefitted.

Reducing the loss on passenger service by a further reduction in the number of high-speed luxury trains by all of the competing lines.

Increasing the speed of the remaining passenger trains and removing the excess fares so as to regain patronage being lost to buses and private automobiles.

Closing of numerous local stations, which may have been necessary in the days of dirt roads and the horse or buggy but now cause needless delay and expense in train operation.

Abandonment of unprofitable branch lines, for the same reason. Where several railroads serve the same territory, some cooperative arrangement should be worked out for abandoning part of the branch mileage.

Scrapping of obsolete rolling stock, notably locomotives, and its replacement with up-to-date equipment in order to reduce the present heavy repair and maintenance expenses.

Pooling of ownership of private refrigerator cars, tank cars, etc., and possibly of all cars, under a single corporation to be owned by the railroads jointly. Under such an arrangement, a smaller number of cars would be required for the railroads as a whole.

Repurchase of outstanding obligations which are selling in the open market at heavy discounts, thereby reducing bonded indebtedness and interest charges, whenever such purchases can be financed without impairing the cash position of the company or weakening the position of other outstanding obligations having a prior lien.

The foregoing steps, and many others that might be mentioned, show what the railroads are doing to adapt their policies to the changing economic needs of the country and at the same time maintain their solvency. To assume that the railroads have outlived their usefulness is absurd, for there is no other industry, except agriculture, so vital to the life of the American people. Expansion of traffic would cause earnings to rise much more rapidly than is generally appreciated.

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